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ABSTRACT

Despite substantial government investment in education in developing countries over the past 4 decades, progress has been uneven and large groups still have very limited access. Since the public sector is unlikely to ameliorate this situation, many countries see an increasing role for the private sector. This paper summarizes current knowledge about private finance and educational management and draws implications for the public policies that will shape the private sector's role over the next decade. Chapter 1 discusses the proportion of total private education enrollments in developed and developing countries and explains why this proportion varies widely from one country to another. Chapter 2 examines the available international evidence concerning differences between public and private schools and universities, focusing on variables such as cost, product mix, quality, and efficiency. Chapter 3 examines in some detail the wide variety of public policies toward the private sector, highlighting issues and problems related to fee financing, public subsidies, government controls, and potential religious, racial, or socioeconomic segregation of the student body. A checklist of questions for policy makers is included, along with tentative conclusions about the proper use of scarce public funds and the role of private-sector funding in education. (MLH)

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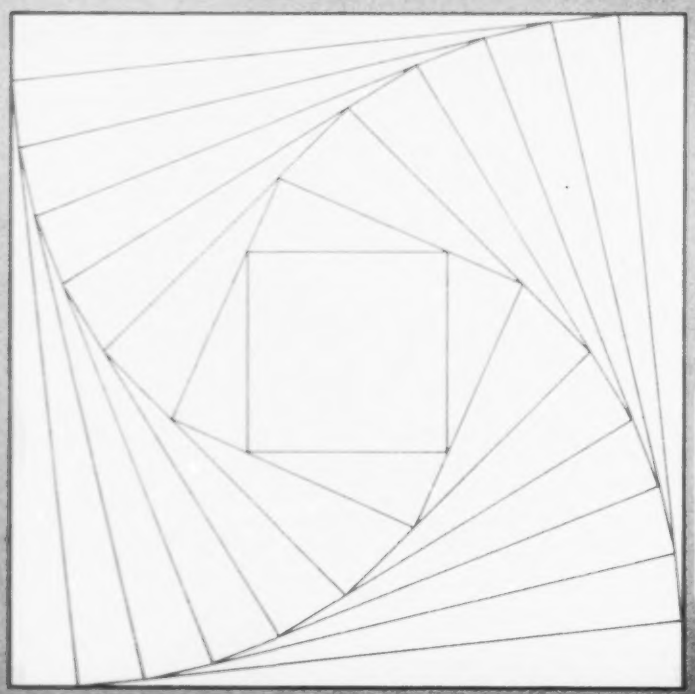
Private finance and management of education in developing countries: major policy and research issues

Estelle James



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Private finance and management of education in developing countries: major policy and research issues

Estelle James

International Institute for Educational Planning

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Introduction

Despite substantial government investment in education in developing countries over the past four decades, progress has been uneven and large groups still have very limited access. Moreover, heavy burdens on the public treasury, together with economic and political limits on taxation, make it unlikely that the public sector alone can solve the vast remaining problem, in the near future. Many countries, therefore, see an increasing role for the private sector. The purpose of this paper is to summarize the state of our knowledge about the current role of private finance and management of education, and to draw implications for the public policies that will shape the role of the private sector over the next decade.

Should private schools and universities be encouraged in developing countries as a means of mobilizing additional resources for education and economizing on public funds? If the government retains financing responsibilities, should it delegate production responsibilities to the private sector, via mechanisms such as voucher schemes, contracting arrangements and subsidies? What impact will this have on the efficiency and equity of the system? Are private schools higher in quality and lower in cost than public schools? Or do they downgrade their product, in order to maximize profits? Do they improve access by increasing the number of schools, or do they give privileged access to upper income groups? Should private schools be regulated by government in order to prevent financial and/or academic abuses? Or do regulations currently on the books do more harm than good? These are pressing issues, both in developed and developing countries. This paper aims to illuminate what we know and what are the knowledge gaps that we need to fill, to inform the policy debate.

Chapter I discusses the proportion of total enrolments that are private in developed and developing countries, current and suggest reasons why this proportion varies widely from one country to another. This is important because the underlying 'raison d'être' for the private sector also shapes its behaviour and sources of financing.

Chapter II examines the available international evidence on differences between public and private schools and universities with respect to important educational variables such as cost, product mix, quality, and efficiency. It is very difficult to get firm data about these factors so the evidence presented is necessarily sparse, but I believe it throws some light on differences between the two sectors, on where these differences stem from and on the further research needed in this area.

Chapter III describes in some detail the wide variety of public policies toward the private sector. Many private sectors rely primarily on fee financing, while others rely primarily on public subsidies and are discouraged, sometimes even prohibited, from charging fees. What is the rationale for these policies and what are their effects? Is there a strong correlation between subsidies and private sector size? Are subsidies accompanied by government controls and if so, over what? When private schools play a large role, facilitated by public funds, does this lead to religious, racial or socio-economic segregation of the student body? This paper summarizes what we know and what we don't know about these questions.

Before beginning my discussion I must make an important point about definitions. The definition of 'private' is by no means clear-cut in situations where many 'private' schools are heavily funded and regulated by the state. In fact, we really have a continuum of public and private funding and control. In this paper I define 'private' as schools that were privately founded, are privately managed, and have some private funding, even though in some cases, most funding and considerable control come from the states. As mentioned above, Chapter III deals in some detail with these mixed cases, in particular, with the effects of public funding on private behaviour.

Chapter I

Determinants of private sector size

Table 1 shows that the size of the private sector varies from 1 per cent to 100 per cent at the primary level, from 0 to 87 per cent at the secondary level, and *Table 2* shows a similarly wide variation at the higher educational level. Two observations stand out: (1) the systematic variation which leads the private sector at the secondary level to be much higher in developing than in developed countries and (2) the seemingly random variation across countries within a given level of education and stage of development.

How do we explain these two observations? This chapter sets forth a conceptual framework for analyzing the role of the private sector in education. This framework is spelled out in greater detail in James, 1986b, 1987a, 1987b and 1991d. I start by assuming that, through some collective choice process, each country (or state or locality) decides how much and what kind of public education to provide. Each family then has three options: to attend a public school if available, to attend a private school, or not to attend school at all. (The latter is particularly an option at the higher education level in advanced industrial societies, but also at the primary/secondary level in developing countries). The private sector can thus be thought of as a market response to situations where some people are dissatisfied with the amount or type of government provision. Two very different patterns of private education have evolved around the world, depending on whether the motivation is excess demand or differentiated demand.

Excess demand

Excess demand for education often exists when the capacity of the public school system is less than full enrolment; that is, the option of attending a free or low-price public school is not available to everyone. If the private benefits from education are high (e.g., because of labour market rewards), many people who are left out of the public schools will seek places in private schools, as a 'second best' solution.

Table 1. Relative role of the private sector in education

	% Private Primary (1)	% Private Secondary (2)	% PVT Sec/ % PVT Prim
12 Modern Industrial Societies, 1980			
Australia	20	26	1.3
Belgium	51	62	1.2
Denmark	7	6	.9
England and Wales*	22	16	.7
France	15	21	1.4
Germany	2	9	4.5
Italy	8	7	.9
Japan**	1	15	15.0
Netherlands	69	72	1.0
New Zealand	10	12	1.2
Sweden	1	2	2.0
USA	10	9	.9
Median	10.0	13.5	1.2
Mean	18.0	21.5	2.6
38 Developing Countries, 1975			
Algeria	1	1	1.0
Argentina	17	45	2.6
Bolivia	9	24	2.7
Brazil	13	25	1.9
Cameroon	43	57	1.3
Chad	10	6	.6
Chile	18	23	1.3
Colombia	15	38	2.5
Costa Rica	4	6	1.5
Ecuador	17	30	1.8
El Salvador	6	47	7.8
Guatemala	14	43	3.1
Haiti	42	76	1.8
Honduras	5	51	10.2
India	25	52	2.1
Indonesia	13	60	4.6
Iran	8	17	2.1
Jamaica	5	76	15.2
Jordan	30	7	.2
Kenya	1	49	49.0
Lesotho	100	89	.9
Liberia	35	43	1.2
Mexico	6	25	4.2
Morocco	5	8	1.6
Niger	5	14	2.8
Nigeria	26	41	1.6
Panama	5	14	2.8
Paraguay	13	37	2.8
Peru	13	37	2.8
Philippines	5	38	7.6
Saudi Arabia	3	2	.7
Singapore	35	1	.0
Sudan	2	13	6.5
Syria	5	6	1.2
Thailand	11	32	2.9
Toga	29	16	.6
Upper Volta	7	43	6.1
Venezuela	13	17	1.3
Median	11.0	27.5	2.1
Mean	16.1	31.3	4.2

Notes and sources for Table 1

* These numbers include both the independent and voluntary aided sectors in the United Kingdom.
** Data include upper and lower secondary. Figure for upper secondary is 28 per cent.

Sweden (1978): Marklund, S. (1979). *Educational administration and educational development.* Stockholm: University of Stockholm, Institute of International Education.

Denmark (1981): Communications with Ministry of Education, Copenhagen.

Rest of Europe (1980): Neave, G. (1985). "The non-state sector in education in Europe: A conceptual and historical analysis." In *European Journal of Education, 20,* 321-337; and Mason, P. (1983). *Private education in the EEC.* London: Independent Schools Information Service.

Australia (1980): Australian school statistics. Canberra: Commonwealth Schools Commission, 1984.

Japan (1980): Mombusho. Tokyo: Ministry of Education, 1981.

New Zealand (1978): Educational statistics of New Zealand. Wellington: Dept. of Education, 1978.

U.S.A. (1980): Digest of educational statistics. Washington, D.C.: National Center for Educational Statistics, U.S.A. Dept. of Education, 1982.

India (1978): Fourth all-India educational survey. New Delhi: National Council of Educational Research and Training, 1978.

Other Developing Countries (1975): World Bank (1986) *Financing education in developing countries.* Washington, D.C.

Note: Most developing country data are for 1975 and most developed country data are from 1980. In the few developed countries for which 1975 data are available, it appears that the percentage of private education has not changed between 1975 and 1980.

The 'excess demand' model most clearly applies to education in Western countries in the nineteenth century and to many developing countries today. Examples are Kenya and Indonesia where the majority of secondary school enrolments are private, Brazil and the Philippines, where the majority of college enrolments are private.[1] In these situations, a political coalition of groups with high tax rates and low benefits from education has limited the supply of government schools, especially at the secondary and higher levels. At the same time, because of the large private benefits to education (such as higher lifetime income and status), many families are anxious to send their children to school, even if they must pay themselves. Under these circumstances, the smaller the capacity of the public sector is, relative to the size of the age cohort, the larger will be the excess demand for the private sector. Excess demand is probably the major reason for the large private sectors found at the secondary and higher levels in developing countries.

1. Among industrialized countries Japan currently best fits the 'excess demand' at both the secondary and higher levels; over one-quarter of all high school (upper secondary) students and three quarters of higher education students attend private institutions, mainly because of limited space in the preferred public schools and universities. See James (1986b), James and Benjamin (1988).

Table 2. Private share of higher educational enrolments and public share of finance

Country	Year	% PVT
Argentina	1982	22
Bangladesh*	1985	59
Belgium	1984	69
Brazil	1980	63
Chile	1980	37
Colombia	1981	59
Costa Rica	1981	8
Ecuador	1980	15
France	1977	7
Guatemala	1980	23
India*	1985	58
Indonesia**	1985	58
Japan**	1980	76
Korea	1985	66
Malaysia	1985	11
Mexico	1981	15
Nepal	1985	24
Papua New Guinea	1985	6
Peru	1980	27
Philippines	1985	85
Thailand	1985	6
The Netherlands*	1983	52
Turkey	1970	25
USA**	1985	23
Venezuela	1981	13

0 - 2% in most countries not listed above, particularly in Europe and Africa, e.g., Germany, Ireland, Sweden, United Kingdom, Australia, New Zealand, Algeria, Benin, Chad, Gabon, Ivory Coast, Kenya, Mali, Niger, Nigeria, South Africa, Tanzania, Iran, Iraq, Israel, Syria, Burma, China, Malaysia, Pakistan, Sri Lanka, Cuba, Uruguay.

* Government covers 80 - 100% of private sector expenditures.

** Government covers 20 - 30% of private sector expenditures.

In other countries listed, less than 10 per cent of expenses of private institutions of higher learning is funded by government or data on public funding of private sector are unavailable. Public universities usually receive over 90 per cent of their funds from the government, except for the USA where this percentage is only 70 per cent.

Sources: *Philippines*: James, E. "Private higher education: the Philippines as a prototype," *Higher Education*, 1991.

Japan: James, E. and G. Benjamin. *Public policy and private education in Japan*. London: Macmillan, 1988.

The Netherlands: "Pocketbook of educational statistics" *(Zakboek onderwijsstat istieken)*. The Hague: Central Bureau of Statistics, 1985.

Belgium: Geiger, R. *Private sectors in higher education*. Ann Arbor: The University of Michigan Press, 1986.

France: Geiger, R. *Private sectors in higher education*. Ann Arbor: The University of Michigan Press, 1986

USA: "Digest of education statistics". Washington: US Department of Education, Center for Education Statistics, 1987.

Latin American countries: Levy, D., *Higher education and the State in Latin America*. Chicago: University of Chicago Press, 1986.

Bangladesh, China, India, Indonesia, Korea, Malaysia, Papua New Guinea, Nepal, Thailand: Tan, Jee-Peng and Alain Mingat. "Educational development in Asia: Cost and financing issues," Washington, D.C.: The World Bank.

Turkey and all other countries: Levy, D. "Alternative private-public blends in higher education finance: International patterns in *Private education: studies in choice and dpublic policy*, ed. D. Levy. New York: Oxford University Press, 1986.

Differentiated demand

A second demand-side explanation views private schooling as a response to differentiated tastes about the kind of education to be consumed. The private sector would then grow larger if people's preferences about educational content and method are more heterogeneous and intense. I expect that important taste differences about education stem from religious, linguistic and nationality differences that concern group identification. The greater the cultural diversity of the population and the more centralized and uniform the public educational system, the larger will be the differentiated demand for private education, much of it coming from cultural minorities.

Private sectors driven by differentiated tastes exist both in developing and developed countries. For example, the 'melting pot theory' and a general belief in assimilation of minorities led to the 'common school' movement in the nineteenth and twentieth century USA, but the growth of Catholic private schools was a response by a group that did not want to be fully assimilated. In India, too, many private schools and colleges accommodate religious or linguistic minorities such as Muslims, Parsees, Sikhs. The same is true of the Chinese and Indian minorities in Malaysia. However, the best example of the 'cultural heterogeneity' model is the Netherlands, where two-thirds of the population attend privately managed schools, a response to the pervasive religious cleavage which dominated that country at the turn of the century (see James, 1984 and 1989a).[2]

Differential preferences about quality can also lead to the development of private schools. In particular, a low quality public sector may stimulate the growth of a high quality private sector, meeting the demand of those willing and able to pay the price. This would be the case, for example, if political pressures led public quantity to expand by taking in more students, without a commensurate increase in educational spending. This phenomenon of private schools differentiated from public along quality lines has been observed at the secondary level in the USA and the United Kingdom and in developing countries such as Brazil, India, and the Philippines.[3]

Non-profit supply

While the size and nature of the private sector in a society is thus partially determined by the source of demand, supply forces also play a crucial role. Private schools are often established as non-profit organizations, i.e. as organizations that cannot distribute a

2. Switzerland, on the other hand, is an example of a country that has accommodated great linguistic differences by a highly differentiated, locally-controlled public school system, in which the Tiebout hypothesis can operate; i.e. people can move to the community that offers the kind of education they prefer. A large private sector is not needed to satisfy differentiated tastes in Switzerland, since the public sector does so.

3. For example, 25 per cent of secondary enrolments in Brazil and 38 per cent in the Philippines are in private schools, which are generally considered to be better than public schools. Brazil and the Philippines have two of the most unequal income distributions in the world. These private school students come from predominantly upper class families and they gain access to the scarce places at the high-quality, heavily subsidized public universities. Other examples from Latin American, where quality-driven private sectors seem to be increasing, are given in Levy, 1986a.

monetary dividend. Indeed, non-profit status is legally required for educational institutions in many countries.

Therefore, we cannot be sure that private schools will spring up wherever a pecuniary profit exists, since non-profit capital and entrepreneurship may not be available. On the other hand, non-profit schools may spring up in situations where for-profits could not break even, because of their lower cost functions due to donated capital, volunteer labour and tax advantages. We must then ask: what are the motives of people who start non-profit schools, and what factors determine their availability?

In answering this question, we observe that most founders of private schools (and other non-profits) are 'ideological' organizations -- political groups in colonial countries such as India and Kenya before independence, socialist labour unions (as in Sweden) and, first and foremost, religious groups. We see this in the origin of sectarian schools in the USA and the United Kingdom, Catholic schools in France and Latin America, Calvinist schools in the Netherlands, ultra-orthodox Jewish schools in Israel, missionary activities in developing countries, services provided by Muslim waqfs (religious trusts) in the Middle East, etc. Usually these are proselytizing religions, using schools as a mechanism for shaping values, socializing old members, and attracting new ones. And competing ideologies have often been forced to start their own schools, as a defensive strategy.[4] This supply-side variable suggests that the private educational sector will be larger in countries with many strong, independent religious organizations competing for members and member loyalty, through their schools. (For a fuller discussion of the motivations and behaviour of non-profit organizations see James, 1989c; James and Rose-Ackerman, 1986).

Government policies

Finally, government policies influence the demand for and supply of private schools. As mentioned above, excess demand and differentiated demand for private education depend critically on the size and nature of the public school system, as determined in part by public educational spending. A second type of policy concerns government regulation of private schools, which may increase their costs and decrease their availability. In extreme cases, private schools have been virtually prohibited; this was the case, for example, with respect to Catholic schools in eighteenth century England and the Netherlands and private schools in Pakistan and Tanzania during the 1970s. A final important policy concerns the provision of public subsidies to private schools, which increases the total effective demand that they face. Most advanced industrial states heavily subsidize their private schools and this is probably one reason why private education has not disappeared as free public schools have become available. The rationale for and impact of these policies will be analyzed in detail in Chapter III of this paper.

4. For example, the caste groups in Southern India and the independence movements in India and Kenya before independence started their own schools, with the expressed intention of inculcating their own values and keeping their members out of the Western-dominated Christian schools.

Statistical testing

I have tested statistically the various hypotheses set forth above -- that the private educational sector will be large where public educational spending is small, where cultural heterogeneity and religious competition are great, and where government subsidizes private schools -- and the results have been consistent with my predictions.

For example, these demand and supply side forces have explained differences in private sector size across states or provinces in the Netherlands, India, Japan, Brazil and the USA (James, 1986b and 1987a). In a cross-national study of fifty countries, the private educational sector was shown to depend heavily on religious competition and entrepreneurship (James, 1987b and 1991d). Linguistic heterogeneity also plays a positive (but somewhat lesser) role, particularly in advanced industrial societies. These findings have important implications for the behaviour of private schools. For example, they suggest that private schools may segment the population along religious, linguistic, nationality or ideological lines, because of the motivations of their non-profit producers and consumers. Many developing countries, particularly those trying to build a new sense of national unity among disparate ethnic and tribal groups, may fear these divisions.

While basic cultural forces thus play a large role, public policies are also crucial. In particular, as public educational spending increases, the percentage of private education decreases. Since public educational spending is particularly low at the secondary level in developing countries, this result is consistent with the excess demand explanation for the large private sector there. This suggests that, as developing countries increase their public spending, some excess-demand-driven private schools will be crowded out, so total enrolments may not rise as much as was anticipated. Obviously, public policies must be formulated with great care and consideration for unintended consequences, in this area. I will return to this topic in Chapter III.

Chapter II

Costs, quality, efficiency and equity

Is the growth of private schools good or bad? Proponents of privatization point to the discipline of market competition in forcing private schools to be cost-effective and oriented toward satisfying consumer preferences. Opponents claim that, in their pursuit of profits, private schools will have an incentive to provide elite education to the upper classes and to downgrade quality for the masses. Non-profit schools and universities are sometimes seen as a desirable alternative to for-profits, on quality grounds. This section sets forth the theoretical arguments and the empirical evidence on these issues. I emphasize important differences between excess-demand and differentiated-demand-driven private sectors, and between non-profits and for-profits, as well as the trade-offs between quality, quantity and access.

Costs

My starting point is the observation that, except for a small number of elite institutions, most privately financed schools and universities operate at far lower cost per student than public schools and universities. This is particularly true in excess-demand situations, but it also holds true in situations where private schools are motivated by religious differentiated demand. For example, private university expenditures per student were 30-40 per cent of public in Brazil, Japan, and the Philippines; private high school expenditures per student were 40-70 per cent of public in Australia, Colombia, Dominican Republic, Kenya, the Philippines, Tanzania and Thailand. (Data for selected years in 1980s. See James and Benjamin, 1988; James, 1986a, 1989b, 1991b, 1991c; Jimenez, Lockheed and Paqueo, 1988; Jimenez, Lockheed, Luna and Paqueo, 1991. For supporting evidence from Latin America see Levy, 1986a).

How do we explain this great cost differential? Some analysts, using inputs as a proxy for outputs, have claimed that this is evidence of low quality. They have argued that private schools should either be subsidized or regulated to raise their costs and, by inference, their quality. For example, the lower costs of the harambee schools in Kenya, the religious primary and secondary schools in Australia, and the private universities in Japan, became the political rationale for the introduction and expansion of subsidies which have raised the private-public cost ratios over the last two decades in these countries (see James, 1986a, 1991c; James and Benjamin, 1988).

On the other hand, some analysts cite the lower expenditures of private schools as evidence of their efficiency, and use this as a political argument for increased reliance on the private market, particularly in developing countries where lower costs may enable greater expansion and access.

Still another explanation for the lower cost of private institutions, especially at the higher education level, is the product mix that they choose to offer. The mix of teaching versus research, undergraduate versus graduate programmes, laboratory science versus social science and humanities, varies widely across universities and may strongly influence their costs, even if efficiency and quality are otherwise equivalent.

The following sections attempt to sort out these contradictory interpretations. I examine public-private differences in product mix, quality and other sources of cost differences. It appears that a small part of the cost differential does indeed stem from product mix differences, at the higher educational level. Differences in quality are much more problematic. The few quantitative studies suggest that value-added by the private sector is at least as great as that of the public sector; however, these studies usually do not cover excess-demand-driven private schools. We are left with the conclusion that in many (but not necessarily all) cases, private schools and universities are more cost-effective than public, and we would like a better understanding of how these economies are achieved. Clearly, this is an area that demands further research.

Product mix differences

My discussion of product mix focuses on higher education, where we find the greatest variation in types of services produced. Let us start by considering a privately financed university that subsists on the basis of fee-for-service. To survive, this university must offer products whose prices will cover their costs. Since people will not pay fees that exceed private benefits, this requires an emphasis on products whose private benefits are high relative to their costs.

For example, we would expect that private funding could be generated to pay for undergraduate teaching, which has a large pay-off to students in the labour market, but relatively little funding will be available for goods with a large 'public' component, such as basic research, whose benefits accrue to society at large. For similar reasons, we would expect private Institutions of Higher Learning (IHLs) to emphasize fields such as management and law, for which demand is high and costs low (because they can be taught in large classes with low capital requirements). The tendency to avoid high cost fields and technologies (such as laboratory sciences) is accentuated if consumers and producers do not have full access to capital markets, because of the difficulties in using educated labour as collateral or foreclosing on a school. For similar reasons, both human capital (faculty members with Ph.D.s) and physical capital (computers, books) are likely to be sparse in fee-financed IHLs, except for those few catering to a wealthy clientèle with a high effective demand for quality.

In contrast, public universities may produce a very different product mix, since most of their funding comes from government rather than from fee-paying consumers. If government perceives a responsibility to fund public goods and remedy capital market

failure, publicly funded universities will carry out more research, graduate education and scientific training, and will use a more capital-intensive technology, then privately funded universities. Consequently, a higher educational system that is primarily privately funded may have a very different product mix from one that is publicly funded. What does the available evidence show?

I have studied this situation in some detail in Japan, Brazil and the Philippines, all of which have large private higher education sectors (see James and Benjamin, 1988; James, 1989b, 1991b; also see Levy, 1986a). As expected, the main function of private IHLs is undergraduate teaching in these countries. For example, 78 per cent of students in the private sector in Japan, 98 per cent in the Philippines, and 99 per cent in Brazil, are either undergraduates or non-degree candidates. Graduate enrolments are correspondingly small, and research even smaller, as demonstrated by the high teaching loads of their faculty.

Also as expected, private universities tend to concentrate on low cost subjects with a high labour market pay-off, such as management and law. Indeed, many private institutions are single-subject faculties, specializing in one professional field; this specialization, too, reduces the cost of entry. The laboratory sciences are virtually non-existent in most of these institutions. Thus, the absence of scientific education may be one important consequence of a privately financed system.

In contrast, the top graduate and research institutions in these countries are public, and these also offer capital-intensive subjects such as science and medicine. For example, 80 per cent of the research universities but only 20 per cent of the undergraduate universities in Japan are public; 60 per cent of the science faculties but only 30 per cent of the economics and business faculties are public. In the Philippines, where there are very few graduate students or science students at any level, those that exist are found disproportionately in the public sector. Similar observations may be made about Brazil and most Latin American countries.[5] Thus, product mix differentials do account for part of the public-private cost differential in higher education. We need studies to determine whether the higher cost of products such as research and scientific education are matched by their higher social benefit.

However, the fact remains that even in most public sectors the main function is undergraduate teaching, only a minority of students are in high cost scientific fields, and only a small number of institutions could be termed major research universities. Thus, even after we control for product mix, most of the cost disparity remains, suggesting that we must look for other explanations as well. I move on now to investigate whether quality differentials account for the remaining cost differential.

5. The USA may appear to be an exception to the rule, since the top American research and graduate universities are private. However, much of the funding for the research is public and is awarded, both to public and private institutions, on a competitive basis. In addition, private universities in the USA receive large grants from foundations and individual philanthropists, giving them discretionary income which they may use to generate externalities and/or prestige. Private universities in most other countries do not have access to these funding sources and must instead rely on sales of services, leading to the kinds of behaviour described in the text.

Quality: reputation and socio-economic background of students

To analyze the relative quality of public and private schools, we must start by defining educational quality. Although people care about many different aspects of education, I focus here on two of the most important, cognitive achievement and future earnings. One major problem is that hard data on these outcomes usually are not available. Another major problem is that superior outcomes are often due to a superior student intake rather than a higher 'value-added' by the school. A school that takes in better students will look good, even if it adds nothing; that is, the student, rather than the school, deserves the credit for subsequent achievements. On the other hand, a school that takes in poor students may not produce the highest achievers even if it adds a great deal. To evaluate the school's contribution it is essential to control for incoming student characteristics, such as ability and socio-economic background. But unfortunately, we usually don't have this information.

Popular perceptions of quality are usually based on the gross outcomes of the school, which depend largely on incoming student characteristics. This, in turn, is closely related to the socio-economic background of students. I start by discussing this perception of public versus private school quality although, as discussed above, this is not a valid measure of the contribution of the school. After that, I present the limited statistical evidence on 'value-added' by public versus private schools.

In advanced industrial societies private schools are often viewed as offering better quality than public schools and, therefore, catering to the upper classes. However, in many developing countries public schools have a better reputation than private schools and serve upper-income groups. How do we account for this difference in reputation and clientèle?

In many developing countries, the number of public school places is very limited relative to the total demand for education; students compete for these places, they are the first choice of most people and are rationed to the best students, who usually come from the highest socio-economic groups. Public school students have higher scores on entrance and exit exams, higher graduation rates, and greater success in the job market thereafter. As discussed in Chapter I, the private sector accommodates the excess demand in these countries; it mainly gets the left-overs, as their second choice.

For example, this has been the situation in Kenya at the secondary level, Brazil and the Philippines at the university level, secondary and higher education in Japan (see James, 1986a, 1991b; James, Braga and Andre, 1991. Also see James and Benjamin, 1988, for recent changes in Japan).

Thus, if we measure quality by the achievement of outgoing students, without controlling for incoming student characteristics, we find it is lower in private schools than in public schools, in countries where the private sector is driven by excess demand. We also find that the socio-economic background of students tends to be as high in public as in private schools in these cases. It is important to realize that the limited size and selectivity of the public sector is responsible for these results.

The situation is quite different in most advanced industrial societies, which have open-access public systems that guarantee a place to everyone. In these countries, the public sector as a whole is not selective (although individual schools may be), and all those in the private sector have gone there voluntarily, even though they had a free or low price public alternative. Therefore, private schools must be considered better than many public schools, by the revealed preferences of their clientèle.[6] Moreover, since free public schools are available to all, we would expect students who choose to attend fee-charging private schools will come disproportionately from high income, educated families; their family background, in turn, will enhance their academic performance.

For all these reasons, in most developed countries private schools have an upper income clientèle and are popularly believed to offer better quality than public schools. Are these perceptions accurate? Do private schools truly have a higher value added, the only valid index of school quality? And do they have a higher or lower value added in developing countries? During the past decade several studies have analyzed this issue, and they will be summarized in the next section.

Value added indicators of quality

Studies of value added are rare, because they require detailed information about the student's family background and cognitive achievement before entering the school in question, as well as achievement measures and/or earnings upon exit. Most of these studies have been done in developed countries, where longitudinal data are more likely to be available.

The most thorough and well-known study of this sort, as well as the most controversial, was carried out in the USA by Coleman, Hoffer and Kilgore (CHK, 1982) and Coleman and Hoffer (CH, 1987). In 1980, extensive data were collected of sophomores and seniors at public and private high schools in the USA (the High School and Beyond sample) and achievement tests were administered at the same time. This enabled an analysis of the difference in cognitive scores between the two cohorts as a function of student and school characteristics (CHK, 1982).

Two years later, when the sophomores became seniors, they were retested, thus enabling a further analysis of cognitive gain for the same cohort (CH, 1987). Both studies concluded that private schools had a significant advantage, even when background characteristics were controlled, and this advantage was particularly great for disadvantaged socio-economic groups.

The CHK and CH analyses were strongly attacked by numerous critics, on grounds that they had not solved the problem of selection bias. These critics argued that there are

6. Part of this preference, of course, comes from the desire for religious identification, one of the non-cognitive outputs of private education. However, since the proportion attending private schools has generally not declined with the increasing secularization of society, other forces must also be at work. A recent study in the Netherlands suggests that private schools have changed from religious marketing to academic quality marketing during the past two decades, and more impressionistic evidence from other countries, including the USA, is consistent with this interpretation (Dronkers, 1987).

likely to be important unobservable differences between the students in public and private schools -- differences in ambition, drive, initiative, competitiveness, self-confidence, etc. Indeed, it is these very differences that cause students to select private schools in the first place, in the American context where private schools have a superior reputation. Suppose that, *ceteris paribus*, more motivated students choose private schools and also reach higher achievement levels because they work harder. Then, private schools will appear to be doing a better job of teaching, whereas actually they have simply been able to capture the more motivated students.[7]

Private schools were also found to perform better than public schools in the United Kingdom. A study of the achievement of 10,000 men who attended secondary school in England and Wales between 1945 and 1970 found that O-level and A-level success was higher in private schools, even when socio-economic background was controlled; much of this was due to the fact that their students were less likely to drop out of school early (Halsey, Heath and Ridge, 1980). In another study, voluntary schools in London were found to perform better than state schools, after controlling for the socio-economic distribution of the student body (ILEA, 1986a & b). Both of these studies, however, suffered from the same weakness as CHK: our inability to observe and measure intangible student characteristics such as motivation and ambition.

A recent analysis of longitudinal data from the Netherlands, where private schools enrol over two-thirds of all students, also suggests that at the secondary level they have a small edge over public schools with respect to academic achievement, although this effect holds only for certain subgroups in the population (see van Laarhaven, Bakker, Dronkers and Schiff, 1987). Once again, student inputs could not be completely controlled since most of the private schools are run by religious organizations and are inherently differentiated along religious lines. On the other hand, there is no *a priori* reason to believe that private school students are more motivated than public school students in the Netherlands, where private schools are virtually free, heavily funded and regulated by the government and public secondary schools are highly differentiated, enrolling a similar socio-economic mix of students. Thus, selection bias associated with ambition and drive is probably absent in the Dutch case. But the private schools may retain a somewhat greater sense of unity and purpose than the public schools, which may account for their small advantage.

In Australia, too, an analysis of longitudinal data showed high school achievement and completion rates to be significantly higher in private than in public schools, even when many other relevant factors are controlled. (Williams, Clancy, Batten and Girling-Butcher, 1980; Williams, Batten, Girling-Butcher and Clancy, 1981; Williams and Carpenter, 1991). However, this study did not control directly for student ability or for unobservable motivational characteristics. A positive Catholic school effect was also found for Scotland,

7. Critics of CHK also argue that, even if the private school effect exists, it is small and short-lived and does not persist beyond college. These and related methodological arguments were made in a lengthy series of papers by numerous economists and sociologists, including Murnane (1985), Goldberger and Cain (1982), Cain and Goldberger (1983) and Alexander and Pallas (1985); an excellent summary of the statistical issues appears in Haertal, James and Levin (1988). Also see James *et al.* (1990) for the absence of a private advantage at the college level.

and this effect became stronger when socio-economic background was controlled (since Catholic schools enrol a relatively low SES student body). (McPherson and Willms, 1987).

Difficult as it is to get the necessary data for analyses of value added in developed countries, it is even more difficult in developing countries. Several World Bank studies have recently begun to fill in this gap. Analyses of value added in secondary schools in Thailand, Colombia, Tanzania and the Philippines show that private schools usually out-perform public schools, after controlling for *exante* achievement and socio-economic background of students. (Cox and Jimenez, 1987; Psacharopoulos, 1987; Jimenez, Lockheed and Paqueo, 1988; Jimenez, Lockheed and Wattanawaha, 1988; Jimenez, Paqueo and de Vera, 1988; Jimenez, Lockheed, Luna and Paqueo, 1991). As in most of the other studies cited above, innate ability and motivation could not be held constant. However, in some of these studies, indirect statistical methods (Hickman's two-step technique) were used to correct for selection bias, and the private school advantage remained. Two of these studies suggested that much of this advantage is due to the peer group effect; the fact that private schools often group together students with superior academic ability and socio-economic background who learn from each other. If this is the case, the private school advantage may simply be a distributional effect in a zero sum game (i.e., if brighter students are grouped together they benefit, but other students lose) rather than an efficiency effect.

In sum, the statistical evidence consistently points to a higher value added in private schools. However, this evidence is still not conclusive. In particular, practically no value-added studies have been done of excess-demand-driven private schools versus elite private and public schools. This is a major gap because, as argued above, most large private sectors in developing countries are motivated by excess demand and these are the very ones whose quality is most subject to criticism. As discussed in Chapter I, we would expect private schools motivated by differentiated demand to be superior in some important respects because they are freely chosen when public alternatives are available, but this is not true of excess-demand-driven schools. Moreover, if the private school advantage is due, in part, to the peer group, this may have a negative rather than a positive effect in excess-demand-driven private schools where students with higher academic ability are grouped together in elite public schools.

For example, one such study compared cognitive development of elite governmental versus non-governmental harambee schools in Kenya and showed superior achievement in the former, suggesting that low-cost harambee schools may not be a good social investment. However, this study had no indicator of *exante* achievement and therefore could not be taken as a measure of value added; it also had no peer group indicators (see Boissiere, Knight and Sabot, 1985). Our knowledge gap on this question consequently remains; this is an important topic for future research.

Particularly important would be a longitudinal analysis of the relationship between schooling and the labour market; this would use future earnings as the dependent variable, student background, type of school or university attended, and field of study as the independent variables (see James *et al.*, 1990, for such a study in the USA). Such studies of value-added to productivity by (public versus) excess-demand-driven private schools are urgently needed to help developing countries decide whether these schools improve the situation by adding quantity or make matters worse by offering sub-optimal quality.

Greater cost-effectiveness

While the value added by private schools in excess demand situations is still unclear, in other situations lower quality does not appear to be the explanation for the lower cost of private schools. Where, then, does this cost differential come from? Economic theory predicts that the discipline of the market (competition plus the desire for profit-maximization) will force private schools and universities to operate more efficiently than public institutions. If so, these efficiencies should show up either as lower inputs per student or lower price per input, or some combination thereof. By decomposing the public-private cost differential along these lines, we may gain some insight into their source and effects, so I have attempted this decomposition in several countries (see James and Benjamin, 1988; James, 1991b).

I found that part of the cost differential does indeed stem from lower inputs per student, such as higher student/faculty ratios, larger class size, fewer books and less equipment. This is especially the case in excess-demand-driven schools and universities. For example, in Japanese private high schools the student/teacher ratio was 23/1, as compared with 17/1 in public high schools; at universities these numbers were 26/1 and 8/1, respectively. Floor space per student was 9/1 versus 12/1 in private and public high schools, 24/1 versus 9/1 in private and public universities. Private universities had, on average, 27 books per student, while national universities had 109. In Filipino private universities the student/faculty ratio in 1985 was 38/1 and teaching loads ranged from 20-30 hours per week, compared with 15/1 and 15-20 hours per week in public universities. In Brazil in 1988 the student/faculty ratio at private universities was 30/1 compared with 9/1 at federal universities. (Data from selected years in 1980s).

Administrative inputs are lower too, in the private sector. For example, it is common for the principal to teach as well as administer; and fewer support staff are used. A similar picture emerges with respect to capital outlays, including the absence of laboratory equipment and books from most private schools, except the elite ones.

However, while these differences in input-output ratios account for part of the cost differential, the largest part of the differential stems from the lower wages paid to workers, especially teachers. Historically, many private schools have benefited from volunteer labour provided by religious personnel who ran the schools. In recent years, this source of low cost labour has sharply diminished, causing financial difficulties for the schools. But even now, and even in secular private schools, teachers are typically paid much less than public school teachers. Many of these teachers would prefer to work in public schools, but are unable to obtain such jobs.

Private schools are more likely to hire workers (such as young women or older retired men) whose market price is low because they have few alternative employment opportunities. In some countries private school teachers have fewer formal credentials, e.g., they lack teacher certification or higher degrees. Another common method of economizing on labour costs is to hire part-time rather than full-time faculty, thereby paying a low hourly wage rate and saving on vacations, pensions and other fringe benefits. As a result of all these mechanisms, in Japan (before subsidies were instituted, in the early 1970s) teacher costs per student in private high schools were only half that in public high schools; about

two-thirds of this gap was due to the lower faculty/student ratio and one-third was due to lower teacher salaries. At private universities in Japan, teacher cost per student was only 25 per cent that of public universities. In the Philippines, public sector salaries ranged between $100-250 monthly, while private sector salaries were almost all less than $100. In Colombia, Dominican Republic and Kenya, teacher salaries at non-elite private schools were only 50-60 per cent those at public schools. (Data for selected years in 1980s except for Japan. See James and Benjamin, 1988; James, 1991b and 1986a; Jimenez, Lockheed and Paqueo, 1988; Jimenez *et al.*, 1991).

It is not clear that these factors, which lower the costs of private schools, necessarily lower their teaching productivity or quality. The private schools may simply have greater flexibility to benefit from market opportunities, to substitute managerial judgment for mandated credentialism. In fact, the previous section suggested that the value added by private schools is often higher than that in public schools. If quality is possibly higher and costs are definitely lower, it seems probable that private schools are generally more efficient than public schools. It would be useful to study whether some of these 'private' practices (e.g., decentralization and competition) could be imported to the public sector, to improve efficiency there.

Equity and access

It is sometimes argued that schools and universities should be publicly funded, and private provision should be discouraged, in order to provide equal access to low income students. However, the evidence presented thus far makes it clear that the equity argument is far from simple.

First of all, we have just seen that private schools are often more efficient than public, hence are a cost effective way of achieving educational expansion. Relatedly, in situations where the public budget is politically constrained, allowing (indeed encouraging) the growth of excess-demand-driven private sectors may be the only feasible way to expand educational opportunity. For example, a study of higher educational enrolment ratios in Asia showed that higher enrolment rates were achieved, and at much lower cost, in countries that rely heavily on private provision, such as Japan and the Republic of Korea (James, 1990). This has important equity implications because larger enrolments, by definition, imply downward filtration. Therefore, policies that permit educational expansion also broaden access.

The argument for private funding is especially strong at the higher educational level, where upper income classes are disproportionately represented in free public universities as well as fee-charging private universities. For example, in Japan and the Philippines the income bias in higher education is equally large in the public and private sectors (see James and Benjamin, 1988; James, 1991b). Students coming from the top income quintile are the beneficiaries of more than 50 per cent of all higher education spending at public institutions, while the bottom quintile receives less than 10 per cent, in Chile, Colombia, Costa Rica, Dominican Republic, Mexico, and Uruguay (see Winkler, 1978; Quintera, 1978; Petrei, 1987; Selowsky, 1979). This is probably true also in most African and Asian countries, but better documentation is needed here. (For preliminary evidence on Asia and Africa see Mingat and Tan, 1985; Tan and Mingat, 1989).

The reason for this income bias is not hard to find. While students from upper income families are more likely to pay the price at private institutions, they are also more likely to pass the entrance exam to selective public universities. Moreover, they are better able to complete primary and secondary schools and to bear the foregone earnings which are the major real cost of college attendance. Public funding of higher education is hardly egalitarian, in this context. Indeed, if the object is equity, the best policy may be to cut down on public undergraduate spending and reallocate these funds instead to greater public spending at the primary and secondary levels. The private sector would then have an important role to play in filling the undergraduate gap; it would be part of rather than antithetical to the pro-equity policy. It would be very useful to study the distributional effects in countries that have adopted differing patterns of allocation for public funds, which in turn implies differing roles for their private sectors.

Do non-profits provide greater quality and equity than for-profits?

Many governments require that private schools be incorporated as Non-Profit Organizations (NPOs) or provide tax incentives for schools to become non-profit. The theoretical rationale is that non-profits, which are prohibited from distributing a monetary residual, are more trustworthy than for-profits and have less incentive to downgrade quality, in situations where consumers cannot assess quality and must rely on producer honesty. Requiring non-profit status is thus an alternative to monitoring by consumers or the government. In theory, non-profits are in a better position to benefit from donations which enable them to subsidize low income students and public goods such as graduate training and research. Are these theoretical predictions borne out in the real world?

Preliminary evidence from the Philippines, Brazil and other Latin American countries is partially consistent with these hypotheses. Non-profit schools and colleges tend to be smaller, more selective, higher quality and higher cost than for-profits. They are likely to enrol more graduate students than for-profits, and relatedly, to do more research. They receive some donations, much of it in the form of volunteer labour (of priests and nuns) or monetary contributions from abroad. In short, they seem to have some of the advantages of publicly financed institutions, while retaining the flexibility, competitiveness and voluntarism of the private sector -- all of which may make them a desirable compromise (see James 1989b and 1991b; Jimenez *et al.*, 1991; Levy 1986a).

However, the same lack of pecuniary motivation and access to donations may lead non-profit managers to be wasteful and to divert resources into personal perquisites. Thus, their higher cost may stem in part from inefficiency rather than higher quality. In addition, when they produce higher quality they enrol a wealthier rather than a poorer student body; contrary to expectations, it is the for-profits that provide cheap private education for the masses. Moreover, private non-profit schools are often founded by broader religious, linguistic or ethnic organizations, and relying on them may tend to segment society along these lines -- contrary to the nation-building goals of many developing countries. Finally, restricting the market to non-profits cuts off the major source of equity capital -- which is usually attracted by the prospect of dividends and capital gains. Thus, if non-profits improve quality, this may come at the expense of quantity and access for lower income groups. Further research is clearly needed on the behaviour of non-profits versus for-profits, in particular, their impact on product mix, costs, quality and distribution.

Chapter III

Public policies toward private education

Chapter II raised a number of important issues concerning the effects of public versus private (and non-profit) provision of education. This Chapter discusses the public policies toward private education found around the world. We shall examine whether these policies seem motivated by the empirical findings of Chapter II, and whether they are likely to change private sector behaviour in more or less desirable directions. This also sets the stage for the re-evaluation of public policies outlined in Chapter IV.

My analysis is based on information collected in 23 developing countries and 14 advanced industrial societies. These data were obtained from a combination of published sources (Mason, 1983; Neave, 1985; World Bank, 1986), research visits to some of the countries, and discussions with knowledgeable government officials and school managers. Some countries have different policies toward their private sectors at the primary, secondary and higher levels. To simplify the exposition, I concentrate my discussion on the secondary level, but most of the analysis applies at all levels. I investigate what kinds of subsidies we find, what regulations accompany the subsidies, and how the subsidies and regulations affect private sector size and behaviour. (For a more detailed discussion of these issues see James, 1991a).

Subsidies: how do they affect private sector size?

Most countries subsidize their private schools, to some extent. The stated rationale for these subsidies is that, because of externalities and lack of information among consumers, private schools and universities would tend to undersupply quantity and/or quality, and, in particular, would be unable to serve low income groups, without public support. This rationale is subject to question because, as we saw in Chapters I and II, many countries have large unsubsidized private sectors and private schools often have higher quality than public schools. An alternative 'public choice' explanation is that subsidies are granted when private school consumers and/or producers (e.g., religious organizations and their members) form a politically influential coalition, with school subsidy as their major goal. This section explores the relationship between subsidies and resulting private sector size.

Ideally, I would have liked to rank each country in my sample according to the ratio of subsidy to total private sector cost. However, precise data on size of subsidy and/or total

expenditures were not available for most countries; private schools jealously guard their financial information. Therefore, I used a rougher grouping: schools were placed into four categories:

I. Those which offer no systematic subsidy;
II. Those which offer indirect subsidy;
III. Those which offer partial subsidy; and
IV. Those which offer almost complete subsidy to their private schools.

Table 3 lists the countries and the kinds of subsidies found in each category.

Table 3. Subsidy categories and their components

I.	No Systematic Subsidy (Algeria, Burundi, Greece, Italy, Madagascar, Mali, Nigeria, Sweden, Tanzania) Occasional ad hoc subsidies.
II.	Indirect Subsidy Only (UPS., United Kingdom independent schools, Japan, Jordan, the Republic of Korea, before 1970, Guatemala, Mexico) Tax benefits (relief from import duties, property tax, income tax); Low interest or guaranteed loans; Student loans or scholarships.
III.	Partial Subsidy (Bolivia, Brazil, Pakistan, Peru, Senegal after 1980, Japan after 1970, some Indian states, Indonesia, Kenya, Liberia, the Philippines) In-kind provision of texts, meals, supplies, equipment; Provision of one or two teachers per school; Subsidized teacher training; Small cash grant; Low rent buildings or shared facilities.
IV.	Almost Complete Subsidy (Belgium, Denmark, France, Luxemburg, the Netherlands, New Zealand, Norway, voluntary aided schools in the United Kingdom, substitute schools in Chile, Germany, state of Kerala in India, Lesotho, Togo); Payment of all teacher salaries; Other recurrent expenses, depending on enrolments; Some capital costs.

Countries in Category I offer no subsidies to their private schools on a regular basis, although occasional ad hoc subsidies may be found. Algeria, Italy and Sweden are examples. Those in Category II feature indirect subsidies such as tax privileges (e.g., relief from import duties, property tax, income tax, sales or value-added tax), or low interest loans (to the schools or their students) which overcome capital market problems. The Mexico, the Republic of Korea and USA fall into this category. Category III countries give, in addition, direct subsidies (covering up to 25 per cent of total costs) in the form of free books, meals

and other supplies, one or two teachers per school, teacher-training, a small cash grant and low-rent buildings. Many developing countries including Kenya, Indonesia, Pakistan, and Peru fall into this category.

Finally, Category IV countries provide heavy subsidies that cover over 75 per cent and sometimes up to 95 per cent of total costs. In these countries, government usually covers teacher salaries, most other recurrent expenses and some capital costs. Often payments are tied to enrolments, on the same basis for public and private schools. Although these subsidies are not called vouchers, we can think of them as implicit voucher schemes since, to a large extent, students have choice and funding follows students. As I will show later, we can also think of them as public-private hybrids because extensive government regulations follow the funding. The best example of this implicit voucher scheme is found in the Netherlands, where the Constitution gives groups of parents the right to start their own privately-managed but publicly funded schools. Other examples are found in Belgium, Chile, Denmark, France and Lesotho. Australia and New Zealand have recently instituted a system which gives private schools access to substantial public funding, providing they also accept certain conditions that I will describe later; most of the Catholic schools in these countries fall into Category IV.

A priori, one might expect that subsidized private sectors would be large and large private sectors would be subsidized. It turns out, however, that the relationship between subsidies and private sector size is much more complex. *Table 4* presents summary data on this relationship, for the 32 countries for which we have data on both variables. Countries are cross-classified by subsidy category and private sector size, with 'large' meaning that the private sector share of secondary school enrolments exceeds the median of 20.5 in Table 1. Categories II and III are collapsed into a simple 'low subsidy' cluster.

First of all, *Table 4* shows us that the majority of countries in my sample (20 out of 32) fall into the zero or low subsidy cluster, with government covering less than 25 per cent of total expenditures and fee finance covering the rest. A large minority (12) offer very high subsidies, covering more than 75 per cent of total expenditures. Practically none falls into the broad middle range of subsidies.[8]

8. Australia, the one exception to this generalization (because its public funding covers 60-70 per cent of total costs), is included in the 'high subsidy' group in *Table 3*. The magnitude of its subsidy scheme has been continuously raised over the past 25 years, and I predict it will soon exceed 75 per cent of total cost. (See James, 1991c).

Table 4. Relationship between subsidies and private sector size

Subsidy	Small Private Sector		Large Private Sector		Total
	Adv Indus.	*Developing*	*Adv Indus.*	*Developing*	
IV	5	1	4	2	12
II & III	3	1	0	10	14
I	3	2	0	1	6
Total	11	4	4	13	32

'Small' private sectors have less than 20.5 per cent of total enrolments.
'Large' private sectors have more than 20.5 per cent of total enrolments.

However, if we disaggregate between developed and developing societies, the picture changes. We find that most developing countries (14 out of 17) fall into the low subsidy categories (historically, many nineteenth century European countries did so as well) while most advanced industrial societies (9 out of 15) fall into the high subsidy category. Empirically, it seems that private schools depend mainly on fee financing in the early stages of economic development, while government funding displaces private funding in the later stages, in many cases.

We also note that most private educational sectors from the developing countries in my sample are 'large' (i.e., they exceed the median), including many with little or no subsidies, while most private sectors in advanced industrial societies are 'small', including some with high subsidies. If we look only at the advanced industrial societies with large private sectors, they all have large subsidies. Thus, subsidies appear to be a necessary but not a sufficient condition for the growth of large private school sectors in modern industrial states. On the other hand, large fee-financed private sectors seem viable in developing countries.

How can large private sectors grow without substantial public support? The answer becomes apparent if we think back to the sources of demand for private education, discussed in Chapter I. We showed there that in developing countries private education is, to a large extent, a response to excess demand. Given its limited resources, the public sector does not provide a place for everyone. But, because the private rate of return is high, many people are willing to pay the price for a private education. Under these conditions, fee-financed private schools flourish; they are highly profitable ventures. Recall from Chapter II, however, that we have little information about the quality of these excess-demand-driven schools.

In contrast, in most modern industrial societies a free public school place is provided for everyone at the primary and secondary levels; hence there is no excess demand. Instead, differentiated demand is the motive for private schooling. Since people always have a free public alternative available, this immediately limits the effective demand for private schools that must charge fees. Therefore, if the private sector is not subsidized in advanced industrial states, it is likely to be small. But those schools that exist are considered high quality, by the revealed preference of their clientèle as well as the value-added studies described above.

What is the relationship between subsidies, controls, costs and quality?

I move on now to discuss the relationship between subsidies, regulations, and private sector quality. Regulations may be imposed because consumers and managers of private education lack information about how to produce and evaluate quality in which case constraints set by better informed government officials make them better off; or they may develop because the values and goals of the government differs from those of some sub-groups in society and government is using its coercive powers to control the actions of (redistribute utility away from) the latter.

Grouping and ranking countries according to their degree of regulations is difficult because of the complex, varied and detailed nature of controls. I found, however, that certain types of controls (regulations of physical facilities) were almost universal; others (academic regulations, organizational and reporting requirements) exist in a large set of countries and still others (regulations regarding teachers and students) apply mainly to countries and schools where large subsidies are granted. I was thus able to construct a rough continuum with respect to regulations, as presented in *Table 5*.

Is there a systematic relationship between subsidies and regulations? At the low end of the subsidy spectrum, such a relationship is hard to discern. Many of the countries that offer no systematic support (subsidy Category I) at the same time impose heavy physical and academic requirements on their private schools. Examples are Greece and Sweden. These schools are typically required to register, to meet minimum health and safety standards and, if a national curriculum or examination system exists, they are required to follow it. Schools that do not comply can be closed down or deemed unacceptable for meeting compulsory attendance laws.

These regulations are typically justified as necessary to protect the health and safety of children or to preserve national unity and integration (i.e., the presumption is that government planners have the 'right' goals and information while educational consumers and producers don't). But, such requirements are costly and reduce the quantity that can be offered by private schools. Indeed, they are designed to discourage private schooling and usually succeed; the unsubsidized private sectors that face heavy physical and academic requirements are small.

Table 5. Types of regulations

I.	*Regulations of Physical Facilities*
	Schools must register.
	Health and safety standards must be met.
	Standards regarding space and furniture must be met.
	Target enrolments are related to physical facilities.
II.A.	*Academic Regulations*
	Schools must follow detailed government curriculum.
	Degree requirements are specified by government.
	Calendar and timetable are specified by government.
	Students must take national exams periodically (e.g., at exit from primary and secondary school or entrance to public secondary schools and universities).
	Medium (language) of instruction is specified.
B.	*Organizational and Reporting Requirements*
	Schools must have non-profit status.
	Schools must submit periodical financial reports.
	Minimum investment is specified[a].
III.	*Teachers and Students*
	Teacher salaries and qualifications are specified by government.
	Procedures and criteria for hiring and firing teachers are specified by government.
	Allocation of budget between teachers and other inputs is specified.
	Fees are controlled by the government.
	Expenditures per student are limited.
	Criteria and procedures for selecting students are specified[b].
	Government representatives serve on managing board of school.
IV.	*Decisions Generally Reserved to Schools*
	Selection of specific teachers.
	Selection of specific students.
	Teaching methods.
	Religious instruction.

(a) These regulations are rare, but potentially important.

(b) Some societies do not permit religion or ethnicity as grounds for selection; others explicitly permit it.

At the level of indirect subsidies (Category II) we find considerable organizational and reporting requirements but no increase (and sometimes even a decrease) in direct control. For example, schools benefiting from tax advantages in the United Kingdom and USA are required to be organized as non-profit organizations and to file detailed financial reports. These institutional arrangements are used to prevent financial abuses and downgrading of quality in situations where central control over education is weak and the

attitude toward private education is hospitable. The presumption seems to be that non-profits are more trustworthy and likely to produce a higher quality product than for-profits. As we saw in Chapter II, the empirical evidence on this question is not very firm. However, politicians may feel that non-profit status reduces the potential political scandal that would ensue if abuses were discovered and therefore it is 'safer' to subsidize non-profits.

A wide variety of countries, most of them developing countries, offer partial support (Category III) to their private schools and the accompanying regulations range from minimal to broad controls over physical facilities, curriculum and fees. These countries apparently do not trust the market to bring private school behaviour into concordance with government interests, because of divergent goals or lack of consumer information, nor do they believe that organizational and reporting requirements will suffice. However, they are torn between regulations that are designed to increase quality or build national unity (e.g., by requiring specified inputs or suppressing minority languages) versus those that are designed to keep prices low, even if this depresses quality.

As an example of the former, Indonesian schools must spend more than their private sources of income to be eligible for aid; in this sense, subsidized schools are turned into non-profit (or zero profit) organizations. They are also required to have at least two 'qualified' teachers and Indonesian must be the language of instruction. Similarly, Pakistan has stated its intention of making Urdu the instructional medium in all schools, thereby undercutting the private schools that consumers use precisely because they do most teaching in English.

As examples of the latter, in the Philippines and Brazil heavy regulatory burdens, including limits on allowable price increases, have appeared in recent years. These controls are a response to political pressures from consumers who do not trust market competition to keep profits and prices low. It is widely believed that many of the regulations that are on the books in these countries are overlooked in practice, that schools have found their way around price controls by invoking 'voluntary' contributions, charges for transport and meals, etc.

For most of the countries in Category III, the positive effects of partial subsidies outweigh the negative effects of moderate controls, so their private sectors are large. However, if the regulations, particularly the price controls, become more binding in the future, they are likely to reverse the flow of resources into education and decrease private school quantity, quality or both.

Finally, we have the group of high subsidy countries, which cover almost all the expenses of their private schools. Recall that most of these are advanced industrial societies. It is hardly surprising that these are also the most heavily regulated schools. And the most universal regulations in high subsidy countries deal with private school inputs, rather than with outputs or their distribution. In the next section I summarize the kinds of controls that are faced by private schools that receive large public subsidies.

Regulations in high subsidy countries

In Chapter II we saw that unsubsidized private schools survive, in part, because they operate with very low costs, particularly low labour costs. In most countries, their teachers teach longer hours, and with much lower wages, than public school teachers. This is a major reason for them being able to cover their costs out of fees.

However, this situation changes drastically when subsidies are granted. Subsidized schools are commonly required to pay their teachers salaries equivalent to those received in the public schools. These schools also face regulations over teacher credentials, teaching hours and other conditions of work, as well as hiring and firing procedures. In effect, private school teachers become civil servants, over whose selection, retention and reward private schools have much less control. This is the case, for example, in France, the Netherlands and Lesotho.[9]

This emphasis on controlling school inputs may stem partially from the fact that government is trying to improve quality and inputs are easier to observe and measure than are educational outputs. However, there is no clear-cut evidence that the mandated inputs will in fact, raise quality. An alternative hypothesis suggests that government goals pertain to producer and worker interests, as well as consumer interests; and many of these regulations are designed to protect the workers. The same forces that lead to civil service regulations in public sectors, lead to similar rules in publicly-funded private sectors.

Through higher wages and improved working conditions the teachers, in effect, 'capture' much of the subsidies. The ostensible purpose, of course, is to avoid croneyism, patronage and wage inequities and to enable the retention of better teachers. However, these regulations also deter private schools from hiring productive workers with lower credentials or from firing poor teachers or from offering positive incentives for superior performance -- constraints which should lead to higher costs or lower quality or both.

While the impact on quality is unclear empirically, it is clear that costs rise dramatically when subsidies are instituted and labour costs rise fastest of all, as demonstrated in my studies of Australia, India, Japan, and Sweden, and India.[10] (James, 1984, 1989a, 1991c; James and Benjamin, 1988). Private schools in these countries had much lower costs per student than public schools when they were unsubsidized, the lower costs facilitated educational expansion, and these were two reasons governments gave for encouraging and subsidizing these schools. Ironically, much of this cost advantage

9. Private school teachers often become unionized in high-subsidy countries, and the unions in effect negotiate with government, as well as school managers. For example, this has occurred in Australia, where the higher wages and job security are due to collective bargaining rather than unilateral government fiat -- and the Labour Government supports the results of collective bargaining by raising subsidies when wages rise.

10. A particularly intriguing example occurred in Kerala, India, when subsidies to private religious schools were introduced in the 1960s by a socialist government, despite its ideological opposition to religion and privatization. The government wanted to pay off its political debt to the teachers union, which included private school teachers; hence a requirement to raise private school teachers' salaries, by a large amount, accompanied the subsidies.

disappeared when large subsidies, together with their accompanying regulations, were introduced.

Besides controlling inputs, government often controls the distribution of the educational service and the criteria for selecting and excluding students in heavily subsidized schools. For example, religion, race and academic ability have been prohibited as selection criteria, in some of these countries.[11]

But the most common distribution rule is to set severe price limits, often close to zero, in high subsidy schools. For example, the Netherlands places a very low ceiling on fees and students cannot be excluded for non-payment. Subsidized schools in Chile and voluntary aided schools in England cannot charge fees. In New Zealand schools, can choose between high subsidies, low fees and low subsidies, high fees. In Australia, too, public subsidies fall rapidly for schools that charge high fees. Thus, fee finance plays a relatively minor role in the private educational sectors of many industrial countries.

These rules show that it is possible to make private schools accessible to students who cannot afford fees, and, therefore, to minimize problems of equity; there is often little difference in the socio-economic mix of students in public and highly subsidized private schools (see James 1984 and 1991c). In addition, by making subsidized private schools almost totally dependent on government funds, in a way which is tied to public school spending, political support for more public educational spending can be enhanced. At the same time, the private schools lose a substantial amount of control over their own student and teacher body and over the mix and level of resources to be used in the educational process. They no longer have the option of raising quality by raising prices. They no longer have the ability to switch resources between labour and other categories. If one 'raison d'être' for encouraging private schools is to decentralize decision-making, and thereby enhance efficiency, much of this 'raison d'être' is eventually, but inevitably, lost with high levels of subsidization and regulation.[12]

In sum, in developed countries subsidies combined with regulations have been effective in maintaining large private sectors, raising their costs and keeping them accessible

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11. For example, academic ability could not be used as grounds for selection in voluntary aided schools in the United Kingdom after the public policy shift to mixed-ability comprehensives. In France, subsidized private schools must become part of the regional catchment area. The price for government support of the mission schools in Kenya after independence and for state support of denominational schools in post-war Germany was that they agreed not to use religion as the basis for selection.

12. Highly subsidized schools also lose control over how to make the few remaining choices, as government mandates the decision-making structure in high-subsidy schools. This is the case, for example, in France, the Netherlands, and voluntary-aided schools in the United Kingdom. Typically, parent, teacher, student and government representatives are required to sit on the governing boards of these schools. This arrangement is designed to maintain social control and democratic accountability over public funds, yet permit some decentralization of production and management at the same time.

By this point, however, the distinction between public schools and publicly subsidized and regulated private schools has become a fine one; we have the public-private hybrid and the definitional problem about 'private' with which I started this paper.

to low income students, at the same time. However, in developing countries large private sectors can and do exist without subsidies, and regulations which raise costs are likely to reduce access; thus there is a trade-off between these goals. In general, I have been unable to find clear evidence that subsidies or regulations have raised quality -- in part because we lack good value-added measures of quality, in part because we still know remarkably little about how to achieve educational quality and which 'private' characteristics are helpful in this respect. Nor do we know whether quantity or quality is more important, in case of a conflict. Clearly, these are high priority questions for future research.

Chapter IV

Conclusion

In conclusion, I wish to suggest a checklist of questions for policy-makers who are considering policy changes toward the private sector and for researchers who are considering work in this area.

1. What is the main purpose of the policy change? Is the object to raise educational quality, to improve efficiency or to increase quantity without requiring additional public funds? If the chief object is to economize on public funds, this requires a privately funded sector. If the chief object is to enhance efficiency through competition, voucher or contracting out schemes can be considered. If the object is quality improvement, the motivation for and production function of quality must first be identified and this is a more difficult problem.

2. What steps should be taken to encourage privately funded schools to start? (Examples are the removal of existing restrictions on and the granting of tax advantages to private schools).

3. How can we minimize the entry of private school owners who downgrade quality in order to maximize profits? For example, should entry (or eligibility for vouchers) be restricted to non-profit schools? (But this may conflict with goals of quantity and efficiency).

4. Should minimum acceptable input-output standards be set? (But government officials may not know the 'right' standards and may raise costs and reduce quantity rather than increasing quality). And, how will these standards be enforced?

5. What kinds of information should be provided to consumers to help them monitory quality through their choice of schools?

6. How can access be provided to low income students in a privately funded system? (Examples are means-tested scholarships and loans; but these incur high transactions cost and therefore reduce the potential savings from privatization).

7. If vouchers or subsidies are used, how will the government determine the total number of places it will fund versus the expenditure per student?

8. In a voucher system, how much autonomy should be given to public schools to allow them to compete? Should public schools and universities be allowed to determined their own programmes and fees? Should they be treated differently from private schools? How will the government react if some public schools and universities do not attract enough students (vouchers) and therefore run the risk of firing teachers and/or shutting down? Is this a politically viable situation?

9. Should the entry of private schools to the subsidy (or voucher) scheme be restricted and, if so, what should the eligibility criteria be? Restrictions on entry may be necessitated by the limited public budget, but this also limits quantity and access.

10. Should participating schools be permitted to charge fees in addition to the voucher value or subsidy? (This may have a positive impact on quality but a negative impact on equity).

11. What should the rationing criteria be if there is an excess demand among students for places or vouchers? Should places be rationed by prior academic achievement? (But this will favour high income students). Should preferential access be given to low income students (running counter to academic achievement as the selection basis)? Should religion or ethnicity be prohibited as selection criteria? (But this will reduce the motivation for starting non-profit schools). Should each institution be allowed to determine its own rationing criteria?

12. If teaching responsibilities are contracted out to private schools, what procedures should be followed in awarding and what terms should be specified in the contracts?

13. Similarly, if research responsibilities are delegated to private universities, what granting or contracting process should be used?

14. Should special loan funds be made available to private schools and their students, enabling them to overcome capital market failure and upgrade their physical and human capital? If so, how will default be minimized?

15. What other 'public' services should be provided to 'private' schools? (Possible examples are in-service teacher training and access to shared libraries).

16. More generally, what is the appropriate role for public funds in a mixed public-private system? (Examples might be financing scientific education and research, student aid and high quality primary education, leaving other functions to the private sector). Running through many of these questions is the potential trade-off between policies that will enhance quantity and access on the one hand versus those that will raise quality, on the other hand. Although the choice between quantity and quality constantly recurs in policy discussions, their relative benefits have rarely been measured. For any given educational budget, and assuming that quality costs, are we better off with a small high quality system or a large, correspondingly low quality system? Do huge low cost excess-demand-driven private sectors serve a useful social purpose by expanding quantity and access, or do they have negative value because they downgrade quality to sub-optimal levels? Numerous consumers in developing countries have opted for quantity (years of education) over quality,

and governments have been ambivalent about this choice, alternatively imposing input regulations with the stated object of raising quality (albeit at the expense of quantity) and price controls designed to facilitate access (albeit at the expense of quality). This ambivalence reflects our lack of knowledge about the relative benefits of quantity versus quality and the social returns to quality. The educational research community should make a serious effort to figure out who is right.

A second major researchable issue concerns the relationships between 'privateness', cost and quality. If a country wishes to have a high capacity system, hence a high level of access, it must keep its expenditure (particularly its teacher cost) per student low, and one way of accomplishing this is through a privately funded system. Does the lower cost per student in the private sector stem from lower quality, in which case we face a quantity-quality trade-off? Or does it reflect higher efficiency in the private sector, in which case a shift toward privatization would expand society's production possibilities frontier?

Although some studies have covered this terrain, the evidence presented in Chapter II demonstrates that we still do not have a definitive answer, especially in the developing country (excess demand) context. To obtain an answer, we would have to analyze educational outcomes, particularly labour market outcomes, controlling for varying student inputs to the two sectors, in a variety of situations. I believe such a study is urgently needed. If private schools are found to be more cost-effective in producing quality, we need to ascertain why and how these market practices can be transferred to the public sector. Some countries are now experimenting with organizational reforms such as greater autonomy and competition in the public sector, or delegating production responsibilities to the private sector through contracts and voucher schemes. Carefully structured comparative case studies of these new public-private institutional arrangements would, in my opinion, have a large pay-off for guiding educational policy over the next decade.

If, on the other hand, private school quality is found to be sub-optimal, especially in excess demand situations, we need to analyze what steps governments can and should take to improve it. Included here would be an exploration of alternative institutional arrangements to regulation, such as the role of consumer monitoring with enhanced information, non-profit organizations, competitive grants processes, and accreditation.

A third major research issue concerns equity. It is sometimes argued that public funding of education is essential in order to provide access to low income students. However, the evidence presented in Chapter II demonstrated that public funding is neither a necessary nor sufficient condition for equity, and public schools are not necessarily more egalitarian than private schools. A more useful way to pose the question, it seems to me, is: What is the most useful allocation of scarce public funds, if the object is to assure equity, and what role is left for the private sector in that case?

For example, we may have a more egalitarian educational system if public funds are primarily allocated to the primary and secondary levels, leaving undergraduate higher education to the private sector. It would be valuable to conduct a cross national study that analyzed the effects of alternative public allocation strategies and alternative private sector roles, on the distribution of educational opportunity.

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The purpose of this paper is to summarize the state of our knowledge about the role of private finance and management of education currently, and to draw implications for public policies that will shape the role of the private sector over the next decade. Should private schools and universities be encouraged in developing countries as a means of mobilizing additional resources for education and economizing on public funds? If the government retains financing responsibilities, should it delegate production responsibilities to the private sector, via mechanisms such as voucher schemes, contracting arrangements and subsidies? What impact will this have on the efficiency and equity of the system? Are private schools higher in quality and lower in cost than public schools? Or do they downgrade their product, in order to maximize profits? Do they improve access by increasing the number of schools, or do they give privileged access to upper income groups? Should private schools be regulated by government in order to prevent financial and/or academic abuses? Or do regulations currently on the books do more harm than good? These are pressing issues, both in developed and developing countries. This paper aims to illuminate what we know and what are the knowledge gaps that we need to fill, to inform the policy debate.

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